1Q14 Earnings Podcast Script
April 16, 2014

Introduction

Hello, this is Laura Brown, Senior Vice President of Communications and Investor Relations. With me is Bill Chapman, Senior Director of Investor Relations. The purpose of this podcast is to provide you with additional information regarding Grainger's first quarter 2014 results. Please reference our 2014 first quarter earnings release issued today, April 16th, in addition to other information available on our Investor Relations website, to supplement this podcast.

Before we begin, please remember that certain statements and projections of future results made in the press release and in this podcast constitute forward-looking information. These statements are based on current market conditions and competitive and regulatory expectations and involve risk and uncertainty. Please see our Form 10-K for a discussion of factors that relate to forward-looking statements.

Company Results Summary

Today we reported record results for the 2014 first quarter and reiterated our sales and earnings per share guidance for 2014. In a quarter that experienced weather-related disruptions in North America and macroeconomic weakness outside of the United States, we delivered solid earnings and margins that were in line with the expectations we provided in the fourth quarter of 2013. At the end of this recording, we'll talk in more detail about our guidance and assumptions.

Let's begin with an overview. Company sales for the quarter increased 5 percent. We had 63 selling days in the quarter, the same as the previous year. Operating earnings increased 3 percent and net earnings increased 2 percent. Earnings per share were $3.07 for the quarter, an increase of 4 percent versus the previous year.

Let's now walk down the operating section of the income statement in more detail. Reported gross profit margins decreased 10 basis points to 45.1 percent versus 45.2 percent in 2013 primarily due to the newly acquired businesses (reference Exhibit 5). Company operating earnings increased 3 percent versus the 2013 quarter. This increase was primarily driven by the 5 percent sales growth, partially offset by lower gross profit margins. Operating expenses also increased 5 percent driven by $31 million in incremental growth and infrastructure spending as well as incremental expenses from the acquired businesses. Our reported company operating margin decreased 20 basis points to 14.9 percent versus 15.1 percent in 2013 primarily due to the decline in gross margins.

On an organic basis, excluding acquisitions and foreign exchange, company gross profit margins for the quarter increased 20 basis points to 45.5 percent versus 45.3 percent in 2013. The company operating margin decreased 20 basis points to 15.0 percent versus 15.2 percent in 2013, primarily due to lower performance in Canada.

We took a cautious approach to growth and infrastructure spending in the 2014 first quarter given softer than expected sales growth in the first two months of the quarter. Given the pacing of projects and lower than expected spending in the first quarter, we are now anticipating full year incremental growth spending of approximately $115 million. We view our commitment to invest in growth as an example of our leadership in the MRO industry and the ability to continue gaining market share over the long term.

Let's now focus on performance drivers during the quarter. In doing so, we'll cover the following topics:

- First, sales by segment in the quarter and the month of March,
- Second, operating performance by segment,
- Third, cash generation and capital deployment, and
- Finally, we'll wrap up with a discussion of our 2014 guidance and other key items.

<u>Quarterly Sales</u>

Before we begin our discussion of sales, please note that although some of our businesses have a different number of selling days due to local holidays, we use the number of selling days in the United States as the basis for our calculation of daily sales. Company sales for the quarter increased 5 percent. By month, increases were as follows: 3 percent in January, 3 percent in February and 8 percent in March. Sales growth in March benefited from the timing of Good Friday that fell in March last year and will occur in April this year.

The 5 percent sales growth in the first quarter included 2 percentage points from acquisitions, net of dispositions, and a 2 percentage points reduction from foreign exchange. On an organic basis, excluding acquisitions and foreign exchange, sales increased 5 percent driven by 4 percentage points from volume, 1 percentage point from price and 1 percentage point from higher sales of seasonal products, partially offset by a 1 percentage point decline due to the extreme weather that closed some customer and Grainger facilities in North America during the months of January and February. The extreme weather resulted in lost sales volume that is not likely to be recovered.

Let's move on to sales by segment. We report two business segments, the United States and Canada. Our remaining operations, located primarily in Asia, Europe and Latin America, are reported under a grouping titled Other Businesses.

Sales in the United States, which accounted for 78 percent of total company revenue in the quarter, increased 7 percent. Sales results in the first quarter included 2 percentage points from acquisitions, net of dispositions. On an organic basis, excluding acquisitions, sales increased 5 percent driven by 4 percentage points from volume, 1 percentage point from price and 1 percentage point from higher sales of seasonal products, partially offset by a 1 percentage point decline due to the extreme weather in January and February. By month, sales increased 6 percent in January, 5 percent in February and 10 percent in March.

Let's review sales performance by customer end market for the quarter in the United States:

- Heavy Manufacturing and Natural Resources were up in the high single digits;
- Light Manufacturing, Commercial and Retail were up in the mid-single digits;
- Government and Reseller were up in the low single digits; and
- Contractor was down in the low single digits.

Now let's turn our attention to the Canadian business. Sales in Canada represented 11 percent of total company revenues in the quarter. The business in Canada continues to face a sluggish macroeconomic environment and unfavorable currency exchange. Sales in the 2014 first quarter decreased 10 percent and were down 2 percent in local currency. The 2 percent sales decline consisted of a 4 percentage points decline from volume, partially offset by a 2 percentage points benefit from the timing of Good Friday.

The weakness in the Canadian economy is being driven by lower commodity prices and a reduction of Canadian exports. By month, sales in Canadian dollars decreased 4 percent in January, 2 percent in February and increased 1 percent in March. The 2 percent sales decrease for the quarter in Canada was driven by declines in the Construction, Light and Heavy Manufacturing, Mining, Retail, Government, and Oil and Gas customer end markets, partially offset by growth from Utilities, Forestry, Transportation and Reseller customer end markets. For reference, approximately two-thirds of revenue is generated in the western provinces with a higher concentration in natural resources.

Let's conclude our discussion of sales for the quarter by looking at the Other Businesses. Again, this group includes our operations primarily in Asia, Europe and Latin America and represents about 11 percent of total company sales. Sales for this group increased 11 percent, which consisted of 18 percentage points from volume and price, partially offset by a 7 percentage points decline from unfavorable foreign exchange. The sales increase was primarily due to solid revenue growth from Zoro Tools and the businesses in Mexico and Japan.

March Sales

Earlier in the quarter, we reported sales results for January and February and shared some information regarding performance in those months. Let's now take a look at March. There were 21 selling days in March of 2014, the same as in 2013. Company sales increased 8 percent versus March of 2013. Sales results in March included 2 percentage points from acquisitions, net of dispositions, and a 1 percentage point reduction from foreign exchange. On an organic basis, excluding acquisitions and foreign exchange, sales increased 7 percent driven by 6 percentage points from volume and 1 percentage point benefit from the timing of Good Friday. Sales were softer in the first half of the month and accelerated as weather conditions improved in North America.

In the United States, March sales increased 10 percent. This increase was due to a 7 percentage points increase in volume, 2 percentage points from the E&R and Safety Solutions acquisitions, net of dispositions, and 1 percentage point from the timing of Good Friday. March customer end market performance in the United States was as follows:

- Heavy Manufacturing, Natural Resources and Retail were up in the low double digits;
- Light Manufacturing and Commercial were up in the high single digits;
- Government was up in the mid-single digits;
- Reseller was up in the low single digits; and
- Contractor was down in the low single digits.

Sales in Canada for March were down 7 percent but were up 1 percent in local currency. The 1 percent sales increase consisted of 5 percentage points benefit from the timing of Good Friday, partially offset by 4 percentage points decline in volume. The volume decline was driven by lower sales to the Construction, Light Manufacturing, Mining, Retail, Government and Reseller customer end markets, partially offset by growth to customers in the Utilities, Forestry, Heavy Manufacturing, and Oil and Gas customer end markets.

Sales for our Other Businesses increased 16 percent in March, consisting of 19 percentage points from volume and price, 1 percentage point benefit from the timing of Good Friday, partially offset by 4 percentage points from unfavorable foreign exchange. Sales growth in the Other Businesses was driven by Zoro Tools and the businesses in Mexico and Japan. In local currency, sales for the business in Japan grew more than 30 percent but were partially offset by a weaker Japanese yen versus the U.S. dollar.

April Sales

Looking ahead to April, daily sales growth to date in April is running in line with the sales growth we reported for March. Keep in mind however that we will face some headwinds from the Easter holiday in the back half of the month.

Now I would like to turn the discussion over to Bill Chapman.

Operating Performance

Thanks Laura.

Since we have already analyzed company operating performance, let's jump right into results by reportable segment. Operating earnings in the United States increased 7 percent versus the 2013 first quarter, while operating margins were flat at 18.7 percent. Gross profit margins for the quarter decreased 30 basis points driven by lower gross margins from the newly acquired businesses and faster growth with lower margin customers. Operating expenses grew at a slower rate than sales, which included incremental expenses from the acquired businesses and $26 million in incremental growth and infrastructure related spending on areas such as new sales representatives, eCommerce and advertising.

For the U.S. business on an organic basis, excluding acquisitions, gross profit margins increased 40 basis points to 46.9 percent versus 46.5 percent in 2013 driven by price inflation exceeding cost inflation. Operating margin increased 30 basis points to 19.2 percent versus 18.9 percent in 2013 reflecting higher gross margins, partially offset by negative expense leverage.

Let's move on to our business in Canada. Operating earnings decreased 35 percent versus the prior year. The decrease was driven by the 10 percent sales decline, lower gross profit margins and negative expense leverage. Gross margins in Canada decreased 20 basis points versus the prior year, primarily due to higher freight costs, along with the effect of unfavorable foreign exchange from products sourced from the United States. Also contributing to the lower operating performance was increased payroll, benefits and severance, and approximately $2 million in incremental spending related to IT system investments. We continue to invest in the business in Canada through this tougher macroeconomic environment to strengthen our operations and better position the business for the long term.

The Other Businesses generated $8 million in operating earnings in the 2014 and 2013 first quarters. This performance included strong results from Zoro Tools, partially offset by lower performance from the businesses in Latin America and costs to evaluate the new online business in other markets.

Other

Below the operating line, other income and expense was a net expense of $2.7 million in the 2014 first quarter versus $1.4 million in the 2013 first quarter.

For the quarter, the effective tax rate in 2014 was 37.7 percent versus 37.3 percent in 2013. The increase was primarily due to more earnings in the United States relative to other jurisdictions with lower tax rates. We are still projecting an effective tax rate of 37.4 to 37.8 percent for the full year 2014.

Cash Flow

Lastly, let's take a look at cash flow for the quarter. Operating cash flow was $168 million versus $176 million in 2013. The lower cash flow was driven primarily by lower trade accounts payable balances related to the timing of inventory purchases. We used the cash flow and cash on hand to invest in the business and return cash to shareholders through share repurchase and dividends. Capital expenditures for the quarter were $66 million versus $43 million in 2013. We paid dividends of $65 million, reflecting the 16 percent increase in the quarterly dividend announced in April of 2013. In addition, we bought back 615,000 shares of stock for $150 million and ended the quarter with 3.0 million shares remaining on our share repurchase authorization. In total, we returned $215 million to shareholders in the quarter.

2014 Guidance

As reported in our 2014 first quarter earnings release, we reiterated our 2014 sales and earnings per share guidance. The sales guidance range remains at 5 to 9 percent. It's important to note that we slightly revised the composition; the low end reflects more volume contribution and less price realization. Let's look more closely at the underlying elements of our expectations:

1. Let's start with gross profit margins.
    a. For the full year, on an organic basis, we continue to expect gross margin expansion to reach 30 basis points at the high end driven primarily by the United States. On a reported basis, we are forecasting minimal gross margin expansion versus 2013 due to lower gross margins from the acquired businesses.

b. For the 2014 second quarter, we expect organic gross profit margins to be down approximately 15 basis points due primarily to one-time inventory transition costs in Canada in preparation for the relocation to the new distribution center in Toronto. On a reported basis, we are expecting gross profit margins to decrease by about 60 basis points due to the acquired businesses.

c. Please keep in mind that as you model margins for the second quarter and the remainder of the year, our first quarter included supplier support provided for our annual customer trade shows. As a result, both gross profit and operating expenses as a percent of sales are inflated by about 100 basis points.

2. Let's take a closer look at company operating margin expectations.
   a. In 2014, we anticipate operating margin contraction in the first half followed by operating margin expansion in the second half. This is due to the carryover effect of the 2013 second half growth and infrastructure spending and the acquisition of the lower margin businesses.
   b. For the full year, on an organic basis, we continue to expect 15 to 45 basis points of operating margin expansion. On a reported basis, we are forecasting full year operating margin expansion of 10 to 40 basis points, reflecting negative mix from the acquisitions.
   c. For the 2014 second quarter, on an organic basis, operating margins are forecasted to decline 40 to 80 basis points due to the incremental growth and infrastructure spending anticipated in the second quarter. Please see Exhibit 4 for more information. For the 2014 second quarter, on a reported basis, operating margins could decline 50 to 100 basis points.

Conclusion

Please mark your calendar for the following upcoming events:

1. On April 30th we will host our Annual Meeting of Shareholders. The script from that presentation will be available on our website following the event.
2. On May 6th, DG Macpherson, Senior Vice President and Group President, Global Supply Chain and International, will present at the Robert W. Baird Growth Stock Conference in Chicago. The event will be webcast.
3. Finally, we will release April sales on Tuesday, May 13th.

Overall, we are pleased with our start to 2014. We continue to invest in the business to gain share and deliver solid returns to shareholders. We appreciate your support and thank you for your interest in Grainger. If you have any questions, please contact Laura Brown at 847.535.0409, Casey Darby at 847.535.0099 or me at 847.535.0881.

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Exhibit 1
2014 Sales Guidance

	April 16, 2014	January 24, 2014	November 13, 2013
Economy/Volume	5% - 8%	4% - 8%	4% - 8%
Price	0% - 1%	1%	1%
Organic Sales	5% - 9%	5% - 9%	5% - 9%
F/X	-1%	-1%	0%
Acquisitions	1%	1%	1%
Company Sales	5% - 9%	5% - 9%	6% - 10%

As of April 16, 2014.

Exhibit 2
2014 EPS Guidance
Total Company

	January 24, 2014*			November 13, 2013		
Sales ($B)	$ 9.9	-	$10.3	$ 10.1	-	$10.4
V% vs. prior yr.	5%	-	9%	6%	-	10%
Op. Margin	14.2%	-	14.6%	14.3%	-	14.6%
bps vs. prior yr.	10	-	40	0	-	30
EPS	$12.10	-	$12.85	$12.25	-	$13.00

*Reiterated as of April 16, 2014.

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Exhibit 3
2014 EPS Guidance
Organic*

	January 24, 2014**	November 13, 2013
Sales ($B)	$ 9.7 - $10.1	$ 9.9 - $10.3
V% vs. prior yr.	5% - 9%	5% - 9%
Op. Margin	14.6% - 14.9%	14.5% - 14.8%
bps vs. prior yr.	15 - 45	15 - 45
EPS	$12.15 - $12.90	$12.23 - $12.98

*Excludes E&R and Safety Solutions acquisitions and foreign exchange.
**Reiterated as of April 16, 2014.

Exhibit 4
Incremental Growth Spending
($ in Millions)

	2014 Incremental vs. 2013	2013 Incremental vs. 2012	2012 Incremental vs. 2011	2011 Incremental vs. 2010
1Q	$31	$22	$27	$7
2Q	$32E	37	24	11
3Q		40	19	19
4Q		31	1	30
FY	$115E	$132	$71	$67

Notes: 1) As of April 16, 2014.
2) The company expects 2014 incremental growth spending of $115 million.

Exhibit 5

Acquisition / Divestiture Schedule

Acquired / Divested	Date	Revenue
Techni-Tool (Acquired)	December 31, 2012	2011 Sales of $88 Million
E&R Industrial, Inc. (Acquired)	August 23, 2013	2012 Sales of $180 Million
Safety Solutions, Inc. (Acquired)	December 2, 2013	2012 Sales of $63 Million
Specialty Brands (Divested)	December 31, 2013	2013 Sales of $96 Million

Exhibit 6

Selling Days: 2014 vs. 2013

Month	2014	2013	Difference
January	22	22	0
February	20	20	0
March	21	21	0
1Q	63	63	0
April	22	22	0
May	21	22	-1
June	21	20	1
2Q	64	64	0
July	22	22	0
August	21	22	-1
September	21	20	1
3Q	64	64	0
October	23	23	0
November	19	20	-1
December	22	21	1
4Q	64	64	0
Full Year	255	255	